UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	:	**Case No. 09-50885**
	:	
Michael T. Fosnaught and	:	Chapter 13
Catherine L. Fosnaught,	:	
Debtors.	:	Judge Caldwell

MEMORANDUM OPINION AND ORDER GRANTING DEBTORS' MOTION TO MODIFY AND PERMITTING DIRECT PAYMENT OF MORTGAGE (DOC. NO. 73)

This matter comes before the Court on Debtors' Motion to Modify Chapter 13 Plan (Doc. No. 73), filed May 20, 2011, the Trustee's Response in Opposition (Doc. No. 76), filed June 9, 2011, and interested party Jeffrey P. Norman's Statement in Support of Trustee's Response in Opposition (Doc. No. 90), filed October 5, 2011. Debtors seek to modify their confirmed Chapter 13 plan so that they may make their mortgage payment directly, as opposed to having it disbursed by the Trustee. The Trustee opposes the Debtors' request.

The Court initially held a hearing on July 12, 2011, which it continued to October 11, 2011, in order to provide interested party Jeffrey P. Norman an opportunity to review and respond to the motion. In the interim, the parties submitted and the Court entered a Limited

Agreed Order (Doc. No. 86) permitting Debtors to pay their mortgage directly, and permitting the Trustee to make regular disbursements until final resolution of the dispute. A final hearing on the matter was held October 11, 2011, with appearances by Debtors' counsel, counsel for the Trustee, and interested party Jeffrey P. Norman.

The background of this case is demonstrative of its complexity. Debtors filed their petition on January 30, 2009. Their Chapter 13 plan was confirmed on March 26, 2009. Section E(2) of Debtors' confirmed plan provides that Debtors would cure pre-petition mortgage arrearages to Monument Street Funding II LLC estimated at $23,294.70. However, special provision 2 of the plan states that the arrearage claim is disputed, that Debtors contend they were current as of filing, and that Debtors would pursue a claim in that regard. Contrary to the estimate in the plan, Monument Street Funding II LLC filed Proof of Claim 10-1 asserting an arrearage of almost $48,000.00.

On March 3, 2010, Debtors filed an adversary complaint, case no. 10-2125. The complaint alleged that, prior to the filing of the bankruptcy case, Debtors home was in foreclosure and scheduled for sheriff's sale. Debtors claim they tendered a $60,000.00 payment in order to reinstate the loan, which resulted in the dismissal of the foreclosure action. However, a second foreclosure was filed almost immediately after the dismissal. This resulted in protracted efforts by Debtors to obtain an accounting, and to determine what happened to the $60,000.00 reinstatement payment. Debtors were unable to do so, and ultimately filed their Chapter 13 proceeding to avoid a second sheriff's sale.

The Court held two pretrial conferences with the parties during the pendency of the adversary proceeding which permitted the parties and the Court the opportunity to sort through the complicated factual issues. A trial was scheduled for June 29, 2011. Ultimately, the parties reached a settlement in the form of a loan modification prior to trial. The court approved the loan modification, and the adversary was ultimately dismissed by agreed order.

The current dispute between Debtors and the Trustee focuses primarily upon the conduit requirement contained in LBR 3015-1(d). The local rule mandates that "[u]nless otherwise ordered by the court, regular monthly payments on a real estate mortgage pursuant to § 1322(b)(5) of the Code shall be disbursed by the trustee if the obligation is in arrears as of the petition filing date." LBR 3015-1(d).

Debtors make three primary arguments against application of the local rule. First, Debtors assert that, even though the mortgage creditor claimed an arrearage existed at the time of filing, Debtors have consistently argued that the loan was in fact current, and that such a bona fide dispute should not require a conduit payment under LBR 3015-1(d). Second, Debtors state that, even if the loan was in arrears at the time of filing, the special circumstances of this case warrant an order excepting them from the requirements of LBR 3015-1(d). Specifically, Debtors' note that the mortgage holder's handling of the loan up to this point has been problematic, and that the added layer of administration imposed by a conduit payment may result in late payments, further fees and penalties, and more litigation. Third, Debtors argue that their mortgage modification was in fact a novation which would remove them from the requirements of LBR 3015-1(d).

The Trustee asserts that the mortgage was in arrears at the time the case was filed, and that a straightforward application of the rule mandates a conduit mortgage payment. Per the plain language of the rule, the applicable time period for determining the existence of an arrearage is the petition filing date. Debtors' schedules, the plan, and the mortgage holder's proof of claim all indicate an arrearage at the time of filing. Thus, the Trustee argues, Debtors' mortgage payment must be distributed by conduit, even if a subsequent loan modification brings the mortgage current. Further, Debtors have not demonstrated the exceptional circumstances that other Courts have typically looked to when considering whether to grant an exception to a conduit payment requirement.

The Trustee also notes that the administration of a mortgage by a Chapter 13 trustee provides debtors certain safeguards they would not otherwise enjoy. Typically bankruptcy trustees can ensure timely payment, which is particularly beneficial for debtors with pre-petition mortgage arrears who may have a questionable history of making payments on time. *See In re Teagardner*, 98 B.R. 318, 321 (Bankr. S.D. Ohio 1989). Chapter 13 trustees also routinely file a motion to deem mortgage current at the end of a case, providing debtors the protection of a court order in the event payment issues are alleged down the road. Finally, the Trustee notes that Debtors fears of late payment penalties may be somewhat ameliorated by case law prohibiting mortgagees from assessing fees which result solely from the administration of the bankruptcy estate. *Waterfield Mortgage Co., Inc. v. Clark*, 31 B.R. 502 (Bankr. S.D. Ohio 1983).

While the Trustee's arguments are well articulated and would apply to a majority of cases involving post-petition mortgage modifications which cure pre-petition arrearages, the Court finds that the complex and unique facts of this case warrant an exception to the general rule. The Court notes that there was never a final determination in the adversary proceeding with respect to the existence of an arrearage. Even assuming there was, the complicated issues and extended litigation that have already muddied the waters in this case make the added variable of administration by a Chapter 13 trustee the less desirable option. As indicated at hearing, Debtors are cognizant of the risks they take on, and the protections they lose, by making their payment directly.

Accordingly, Debtors' Motion to Modify is hereby **GRANTED**. Debtors are excused from the conduit mortgage requirement of LBR 3015-1(d), and shall make all future mortgage payments directly.

IT IS SO ORDERED.

Copies to:

Default List
John W. Kennedy, Esq., 10 West Broad Street, Suite 900, Columbus, OH 43215
Jeffrey P. Norman, Chapter 13 Trustee, 10 West Broad Street, Suite 900, Columbus, OH 43215